

24 September 2021

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

Project reference code: ERC0325

Dear Ms Collyer

RE: Transmission Planning and Investment Review

TasNetworks welcomes the opportunity to lodge this submission to the Commission's consultation paper on its Transmission Planning and Investment Review. The purpose of this submission is to highlight issues that are particularly relevant to Project Marinus.

Project Marinus is an actionable Integrated System Plan (**ISP**) project that is currently progressing through the design and approvals phase, and provides useful insights on a number of the issues raised in the consultation paper. As a member of Energy Networks Australia, TasNetworks also supports the views expressed in its submission.

In the attachment to this letter, we focus on the high level questions outlined early in the consultation paper that capture the key issues raised in this review. In addition to addressing these questions, we also comment on the Rule change proposal which raises important questions about when a RIT-T process should be revisited, and which party should be responsible for making that decision.

To summarise, the key points in the attachment are:

- The existing regulatory framework requires further changes to address the particular challenges arising from actionable ISP projects. In particular, our view is that amendments should be introduced to allow the AER to accept forecasts based on competitively tendered prices, as much of the intrinsic uncertainty associated with ISP projects would be resolved once tendered prices are known. This approach, which would involve bespoke stakeholder engagement, would build on the existing provisions relating to 'early works' that also assists in reducing uncertainty.
- TasNetworks does not support the introduction of contestability, principally for three reasons:

- ⇒ Firstly, the establishment of arrangements to allow for the contestable provision of transmission projects will be costly to implement and result in unnecessary ongoing operational complexity.
 - ⇒ Secondly, the consultation paper is concerned that a Transmission Network Service Provider (**TNSP**) may decide not to proceed with a project that satisfies the RIT-T. However, if the revenue and cost allocation arrangements are soundly based, there is no reason to suppose that such refusals would occur (and none have occurred to date). Furthermore, introducing contestability would not resolve the issues in the regulatory framework that led to the refusal.
 - ⇒ Thirdly, ISP projects are already substantially outsourced and therefore customers already obtain the benefit from competitive markets.
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- In relation to the Rule change request, we support the Commission's analysis in its consultation paper. In particular, we support the suggestion that a project proponent should develop 'decision rules' for inclusion in the Project Assessment Conclusions Report (**PACR**) that capture, in broad terms, the circumstances that would lead to a reapplication of the Regulatory investment test for transmission (**RIT-T**). However, these arrangements should only apply to actionable ISP projects, which warrant the development of 'decision rules' given the magnitude of these projects.

TasNetworks notes that the cost allocation arrangements for ISP projects are outside the scope of the Commission's review. Nevertheless, the social licence for these projects depends on pricing outcomes that are acceptable to customers. For that reason, the cost allocation arrangements remain an important framework issue to resolve.

If you would like to discuss our proposal, please feel free to contact me or Heath Dillon, Leader - Revenue and Pricing, on 0419 318 806 or by email heath.dillon@tasnetworks.com.au

Yours sincerely



Stephen Clark

Acting General Manager, Marinus Link

Attachment: Submission to the Transmission Planning and Investment Review

As explained in the covering letter, in this attachment we focus on the specific questions raised in the consultation paper¹ from the perspective of Project Marinus. The questions are presented under the topic headings in the consultation paper. In addition to addressing these questions, we also comment on the Rule change request relating to the reapplication of the RIT-T in the event of a change in project costs.

Regulatory framework for transmission planning

Is the existing ex-ante incentive-based approach to regulation appropriate in light of the significant intrinsic uncertainty associated with the costs and benefits of major discrete transmission investments? (Consultation paper, section 3-1)

TasNetworks agrees with the Commission's observation that the intrinsic uncertainty in relation to major transmission projects calls into question the appropriateness of the ex-ante framework. Our view, however, is that contestability is not the appropriate remedy to address this uncertainty. Contestability will price this uncertainty into the charges levied on customers, but it will not remove or reduce it. Contestability will also introduce new costs associated with the ongoing complexity from increasingly fragmented transmission development and operation. As explained below, a better approach is to adjust the ex-ante framework so that it applies to forecasts that are developed later in the planning process.

The purpose of the ex-ante framework is to provide the TNSP with a financial incentive to meet customers' needs at the lowest total cost to customers. This framework is appropriate if the TNSP's expenditure requirements can be forecast with a reasonable degree of certainty. In these circumstances, the difference (positive or negative) between the AER's expenditure allowance and the actual costs incurred is more likely to be attributable to the efficiency of the TNSP.

For major transmission projects, it is more likely that the difference between an expenditure allowance and the actual expenditure will be attributable to forecasting error in the face of a range of material uncertainties, rather than the TNSP's efficiency performance. In these cases, therefore, the ex-ante framework is more likely to produce windfall gains or losses for the TNSP or customers. The regulatory framework should be designed to avoid windfall gains or losses, as they undermine the credibility of the regime and serve no economic purpose.

TasNetworks' view is that the challenges of forecasting major transmission projects is partly ameliorated by the 'early works' provisions, which provides an opportunity for the TNSP to clarify the project scope and progress key route planning and design activities, and associated environment, land use planning, landowner and community engagement activities. In addition to these provisions, uncertainty can be further reduced by allowing the AER to adopt forecasts based on competitively tendered prices. Under this approach, project cost estimates would be updated following the completion of the design and approval phase of a project, to reflect feedback from bidders received through the competitive tender process.

The AER's revenue determination process could adopt these updated forecasts, which will eliminate most of the intrinsic uncertainty that would otherwise undermine the effectiveness of the standard ex ante framework. This approach could be combined with a specially designed stakeholder engagement to provide the AER with confidence that the updated forecasts are prudent and efficient, and should be adopted by the AER in the revenue setting process.

¹ AEMC, Consultation Paper, Transmission Planning And Investment Review 19 August, page 2.

TasNetworks considers that there is scope to develop a bespoke, collaborative stakeholder engagement approach to ensure that the TNSP's tender and procurement decisions are consistent with delivering prudent and efficient capital expenditure. An example could include a consumer reference group contributing to the views taken into account by TNSPs in deciding to transfer risk to contractors to achieve greater cost certainty, in exchange for higher contract prices.

TasNetworks' view is that allowing the AER to accept updated forecasts that reflect competitively tendered prices for large discrete projects is a targeted and proportionate remedy to the issues raised in the consultation paper. In contrast, the introduction of contestability to address this issue would lead service providers to price the uncertainty into their bids, resulting in higher costs for customers. The intrinsic uncertainty highlighted in the consultation paper can only be addressed by delaying the project cost forecasts until there is greater clarity regarding the project design and the outturn tender and procurement costs. A modified ex-ante process can then be applied to the project, once the updated forecasts have been developed. A separate ex-ante allowance could be provided for 'early works', which could include the costs of the activities required to establish the updated project forecasts.

Is the economic assessment process too complex and impacting the timely delivery of projects? (Consultation paper, section 3.2)

The consultation paper explains that the ISP, RIT-T and AEMO feedback loop each has an important role in the economic assessment of actionable ISP projects. However, their interrelated nature raises questions around whether the economic assessment process for actionable ISP projects is appropriately designed. In particular, there may be a degree of duplication or redundancy in the process and, consequently, there may be opportunities to streamline it.

For Project Marinus, we are aware of challenges in the interplay between the ISP, RIT-T and AEMO's feedback loop. For example, the task of completing the RIT-T may be complicated by on-going revisions to input data, as AEMO updates its inputs, assumptions and scenarios ahead of publishing its next ISP.

A risk is that the RIT-T cannot be brought to a timely conclusion because new information becomes available that requires the market modelling to be revisited, involving several months of re-work followed by further stakeholder consultation. This process could be continually repeated, as new information continues to become available either through market developments or ISP publications, to the point a project may be identified as needed in ISPs but not able to be developed and commissioned in the time available.

TasNetworks' position is that a pragmatic approach is required that recognises the substantial value that is provided by the ISP and RIT-T processes, but does not lead to delays in reaching an investment decision. For example, in the case of Project Marinus, the Project Assessment Conclusions Report found that the staged 1500 MW interconnector is the preferred option, but its optimal timing should be determined by the subsequent ISP, which is to be published in June 2022. In this particular case, this approach appropriately balanced the need to complete the RIT-T process and the value provided by the updated analysis in the subsequent ISP.

In summary, the interplay with the ISP, RIT-T and feedback loop is complex. It does not follow, however, that one or more components of the framework should be removed, as each has an important role to play. It is essential, however, that a pragmatic approach is taken by TNSPs, AEMO, AER and stakeholders to ensure that the regime is workable and project decisions can be made in a timely manner. As noted in ENA's submission, placing a timeframe around the

feedback loop process may also be helpful, so that it does not add significantly to the end-to-end process.

In our view, the current Rules provide sufficient flexibility for the participants to apply the provisions pragmatically so that projects are not subject to extensive delays or unnecessary rework. We note, however, that the Commission may consider it helpful to make changes to ensure that the framework can be applied pragmatically, having regard to the overall purpose of the framework which is to promote prudent and efficient transmission investment.

Are the benefits included in current planning processes (i.e., the ISP and RIT-T) sufficiently broad to capture the drivers of major transmission investment? (Consultation paper, section 3.3.1)

There are a range of other benefits that society properly values – and it may be prudent to ensure that the investment framework is capable of taking them into account. This is particularly the case in the context of undue precision being applied to RIT-T outcomes, where a broader consideration of benefits may strengthen an investment case.

Is there a disconnect between what is required under the Rules and feasible in practice and does this disconnect warrant guidance on hard to monetise benefits? (Consultation paper, section 3.3.2)

The consultation paper notes that some categories of benefits (such as changes in ancillary costs and competition benefits) are not often estimated due to the complexity and cost of the modelling task. Furthermore, the consultation paper notes that if project costs subsequently increase, it may be necessary to revisit these additional benefits to justify the project proceeding.

In relation to this issue, TasNetworks supports the observation in ENA's submission that further guidance is not needed in relation to 'hard to monetise' benefits. For Project Marinus, the PACR noted that option value and competition benefits may further advance the case for the project, but it was not necessary to quantify them to identify the preferred project option. As noted in ENA's submission, it is appropriate to calculate benefits up to the point where it is material to the choice of preferred option.

Have changes occurred in the energy sector that warrant reconsidering the merits of a market versus consumer benefits test? (Consultation paper, section 3.3.3)

No. The market benefit test is the appropriate investment test, as it promotes efficient investment in accordance with the National Electricity Objective. TasNetworks therefore agrees with the Commission's view that a market benefits test remains fit-for-purpose.

Are there barriers that prevent the equal treatment of non-network options under the RIT-T? (Consultation paper, section 3.4)

No. TasNetworks considers that there are numerous safeguards in the planning and investment framework to ensure that network and non-network investments are considered on an equal footing. For example:

- TNSPs are required to prepare and publish information to facilitate the non-network provision of inertia services and system strength services (NER clauses 5.20B.4 and 5.20C.4);
- TNSPs are required to consider non-network options in their Transmission Annual Planning Report (clause 5.12.2);

- TNSPs and AEMO are required to consider non-network options in conducting their joint planning obligations in relation to the ISP (clause 5.14.4);
- AEMO is required to seek submissions from non-network proponents in developing its ISP (clauses 5.22.12 and 5.22.14); and
- TNSPs are required to consider non-network options in the application of the RIT-T.

In addition to these planning processes, the AER is required to consider the extent to which the TNSP has considered and made provision for efficient and prudent non-network options.² This requirement reinforces the importance of non-network options in the development of the TNSP's expenditure plans. In addition to these formal requirements, the regulatory framework provides financial incentives to deliver the lowest cost solution for customers, and therefore supports the adoption of efficient non-network solutions.

In relation to Project Marinus, non-network options were examined through the application of Ernst & Young's market expansion model, which determined the least cost evolution of the NEM to 2050. An important aspect of Ernst & Young's market modelling is that it selects the lowest cost combination of generation, storage, demand-side response and transmission investments. Each option for Project Marinus is therefore accompanied by other investments across the NEM to meet customers' electricity needs, without favouring any particular types of project or response.

In summary, TasNetworks considers that the current planning and investment arrangements set out extensive requirements to ensure that non-network options are considered alongside network solutions. On that basis, we do not consider that there is a need for further safeguards to ensure that non-network options are actively considered in TNSPs' investment plans.

Regulatory framework and processes for transmission investment and delivery

Are changes to the exclusive right of TNSPs to provide regulated transmission assets required or what other options could be considered to ensure timely investment and delivery of major transmission projects? (Consultation paper, section 4.1)

The consultation paper explains that the proposed rule change 'Participant derogation regarding the financeability of ISP projects' has brought to light characteristics of the current regulatory framework that could lead to projects not being delivered or being delayed. In this context, the consultation paper notes that TNSPs have an exclusive right, but no obligation to deliver transmission projects. The consultation paper also notes that there are currently no alternatives if a TNSP decides not to deliver a project, and there are no regulatory consequences for the TNSP should it choose this course of action. A broader framework issue for consideration, therefore, is whether parties other than incumbent TNSPs should be permitted to invest in regulated infrastructure.

TasNetworks does not accept the Commission's observation that TNSPs have an exclusive right to deliver regulated transmission projects, but no obligation to deliver investments. In reality, TNSPs are required to meet their compliance and service obligations, as mandated by the Rules and any jurisdictional requirements. For those projects that are not driven by compliance or service obligations, there is no reason to suppose that a TNSP would decide not to proceed providing that the project is commercially viable and in customers' interests. We believe, the only instance that a TNSP may not proceed with a project if the cost allocation of the project was

² NER clause 6A.6.6(e)(12)

inequitable.

As TNSPs are commercial and customer-orientated organisations, a decision not to proceed with a project is prima facie evidence that the regulated rate of return and/or revenue profile are not sufficiently attractive to investors, and/or that the customer cost recovery framework makes proceeding untenable. In these circumstances (which have never eventuated to date for projects with acceptable cost allocation outcomes), the remedy would be to revisit the revenue setting process to ensure that it is able to finance transmission projects.

The consultation paper suggests that contestability may provide the solution to the issue raised. In a narrow sense, contestability would address the issue because the commercial bids that are received would ensure that the relevant project can be financed. Logically, however, these commercial bids should be expected to be substantially higher than the equivalent regulated revenue for that project, as these bids will provide a revenue stream that is capable of attracting investors. For customers, the key question is whether the contestable provision of transmission services would provide a better outcome.

In addressing this question, it is important to note that TNSPs already competitively procure contractors to deliver major infrastructure projects. Therefore, there is unlikely to be a cost advantage in seeking the contestable provision of transmission services, as a regulated project would already benefit from competitively sourced service providers.

**Is clarification on the treatment of 'preparatory activities' and 'early works' required?
(Consultation paper, section 4.2.1)**

Yes, there is value in clarifying this terminology, given that 'preparatory works' is defined in the Rules, whereas 'early works' only appears in the ISP and the AER's Cost Benefit Analysis Guideline and the AER's Guidance Note - Regulation of Actionable ISP Projects.

**What is the impact of jurisdictional environmental and planning approval processes on the timely and efficient delivery of transmission investment and are any changes necessary?
(Consultation paper, section 4.2.2)**

In relation to sources of delay in progressing the delivery of transmission projects, the consultation paper notes that the length of the planning and construction processes involved in the delivery of regulated transmission infrastructure has been raised by various stakeholders. In addition, given the cross-over between national and jurisdictional frameworks, the Commission proposes that its review explores issues in relation to whether the current cost recovery arrangements impact TNSPs' ability to meet jurisdictional requirements in a timely manner.

TasNetworks notes that environmental and planning issues are important sources of cost and route uncertainty. We therefore support the Commission's view that there is value in exploring whether the planning processes can be improved to reduce the risk of delays and promote better understanding of the planning requirements early in each project's development.

Material change in project costs Rule change request

TasNetworks notes that this Rule change request seeks to remove the existing discretion in the Rules by imposing strict project cost thresholds (in percentage terms) that trigger a reapplication of the RIT-T. In particular, under the Rule change request, the RIT-T would be reapplied to transmission projects where the total assessed project cost was found to have increased by:

- 15 per cent or more for projects that cost less than \$500 million in total; or
- 10 per cent or more for projects that cost more than \$500 million in total.

These threshold values are lower for distribution projects, being \$200m. For costs below the threshold amounts, the Rule change request proposes that the AER would be able to exercise its discretion to waive the requirement to reapply the RIT-T.

TasNetworks agrees with the Commission's analysis of the Rule change request. In particular, by taking a fixed percentage approach, the proposed Rule is likely to require the RIT-T to be reapplied unnecessarily. Such cases will arise where the cost threshold is exceeded, but the cost-benefit analysis in the PACR shows that the preferred option is not affected by this level of increased costs. Evidently, in these cases the proposed Rule change would lead to the inefficient reapplication of the RIT-T, with cost implications for the networks and their customers.

TasNetworks also supports the Commission's view that the inclusion by the project proponent of bespoke 'decision rules' in the PACR is a better approach than the Rule change request. In particular, it allows the characteristics of each project to be considered in identifying the particular changes in circumstance that would warrant a reapplication of the RIT. Importantly, in addition to considering project cost increases, this approach considers the costs of competing options and changes in benefits. Furthermore, by exposing the proposed decision rules to stakeholder consultation before finalisation in the PACR, such arrangements will promote transparency by clarifying the circumstances in which a reapplication of the RIT-T will be undertaken.

While TasNetworks is supportive of the 'decision rules' concept, it is appropriate that it only applies to ISP projects, given the materiality of these projects compared to projects that are renumerated through a revenue reset.